Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Hollingsworth & Soto, et al. Analyst: Darrine Distefano Bill Number: SB 438

Related Bills: See Prior Analysis Telephone: 845-6458 Amended Date: 02-24-2004

Attorney: Patrick Kusiak Sponsor: ______

SUBJECT: Disaster Loss Deduction/Excess Loss Carryover/Los Angeles, San Bernardino, Riverside, San Diego, & Ventura County Fires

__X__ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended February 4, 2004.

_____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended ______.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO ______.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED February 4, 2004 STILL APPLIES.

__X__ OTHER - See comments below.

SUMMARY

This bill would allow taxpayers special tax treatment, called disaster loss treatment, for losses sustained as a result of the Southern California wildfires, losses related to the wildfires, and the San Simeon earthquake.

SUMMARY OF AMENDMENTS

The February 24, 2004, amendments delete the term "any other related casualties" for losses related to the wildfires and add specific language to include floods, mudflows, and debris flows that were a direct result of the Southern California wildfires. The amendments do not impact the department's operations.

The revenue estimate provided in the department's prior analysis still applies and is included below for convenience. The remainder of the department's analysis of the bill as amended February 4, 2004, still applies.

POSITION

Support.

At its February 25, 2004, meeting the Franchise Tax Board voted 2-0 to support this bill with the representative of the Department of Finance abstaining.

Board Position:			Legislative Director	Date
_____ S	_____ NA	_____ NP		
_____ SA	_____ O	_____ NAR	Brian Putler	3/5/04
_____ N	_____ OUA	__X__ PENDING		

ECONOMIC IMPACT

Revenue Estimate

Based on the discussion below, the revenue losses from this bill are as follows (assumes fast track legislation enacted before April 2004):

Estimated PIT Revenue Impact SB 438 as Amended February 24, 2004 (In Millions) Fiscal Year Impact			
2003-2004	**2004-05**	**2005-06**	**2006-07**
Minor loss	-$5	-$9	-$4

Minor = Less than $500,000

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The impact of this bill would depend on the amount of disaster losses carried back, carried forward at 100% instead of 60%, and the amount of carryover losses deducted in subsequent years.

The estimated losses were determined in several steps. First, it is assumed that the special disaster loss treatment provided in this bill would be for losses sustained as a result of the Southern California wildfires, the floods, mudflows, and debris flows, and the San Simeon earthquake. Second, the total amount of damages for the Southern California wildfires was estimated to be $2.8 billion and the total amount of damages from the San Simeon earthquake was estimated to be $34 million in private losses.

It is estimated that approximately 20% of fire damage and 90% of the earthquake damage would not be reimbursed by insurance coverage for a total deductible loss of $590 million ($2.8 billion x 20% + $34 million x 90% = $590 million).

In order for a taxpayer to calculate the amount of disaster loss that can be deducted, the taxpayer uses three factors. First, the loss must be limited to the basis of the property (cost of the property plus cost of any improvements minus deductions such as depreciation). Second, any insurance proceeds or reimbursements must be deducted. Third, the taxpayer subtracts 10% of their federal adjusted gross income (AGI). The remaining amount is the disaster loss that can be claimed by the taxpayer. Using the department's disaster loss model, after applying qualifying losses for AGI and basis limitations of $147 million and an estimated first year usage of $148 million (historical use of similar losses under current law), it is projected that $250 million in losses would be allowed to be carried forward under the bill ($590 million - $147 million - $148 million = $295 million).

At a 6% average marginal tax rate, the total revenue loss over a period of a few fiscal years is estimated to be approximately $18 million, all attributable under the Personal Income Tax Law (PITL) ($295 million x 6% ~ $18 million).

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